

The Effect of Out-of-Town Buyers on Market Value in a Small Kansas Community

Marion R. Johnson, CAE, and Rick Stuart, CAE

Abstract

When out-of-town buyers purchase property above the going market rate, should these sales be considered valid in the valuation process for property tax purposes?

When validating a sale transaction to determine if the sale is a valid arm's-length transaction, appraisers rely on the standard definition of fair market value. Are the buyer and seller each acting prudently and knowledgeably? Is the price affected by undue stimulus? Are both parties well informed or well advised? These are just some of the questions appraisers will try to answer to determine if the sale price is representative of fair market value. Appraisers are familiar with the complaint from buyers who say they paid too much for a property for a variety of reasons. Appraisers are also familiar with the supposition frequently put forward by local residents of a community or neighborhood that the buyer was from out of town, did not know the market, and paid too much for the property in question. Frequently appraisers hear that the buyer paid above market value because he or she wanted the property for a specific purpose.

This type of situation raises several questions: Should assessors be using the sales by out-of-town buyers in the valuation process for tax purposes? Should sales in which a property was bought for a specific purpose be considered valid open-market transactions and used to value similar properties in the neighborhood? If the answer to either of these questions is "yes," then when do these sales begin to reflect the actual market value in the community or neighborhood? At what point do the out-of-town sales become the market? Yet another concern is what effect will the sales have on the assessment jurisdiction's annual sales ratio study?

This article will review a real situation in a small community in Kansas and the effect it has had on the market and taxable value of comparable properties in the community.

The Community

Sedan is the county seat of Chautauqua County, Kansas. The county is located in southeast Kansas along the Kansas–Oklahoma border. The county is one of the poorest in the state, with an assessed value of only \$20,756,143 in 2000. The assessed value for commercial property in Kansas is 25 percent of market value. The assessed value in Sedan in 2000 was \$2,605,510. The main industries in the county are agriculture and oil production. The county has a population of 4,360, and the population of Sedan is 1,276. The current parcel count in Chautauqua County is 5,200 and in the City of Sedan, 731.

Marion R. Johnson, CAE, is the county appraiser for Douglas County in Lawrence, Kansas, and Rick Stuart, CAE, is the county appraiser for Jefferson County in Oskaloosa, Kansas.

The statements made or views expressed by authors in Assessment Journal do not necessarily represent a policy position of the International Association of Assessing Officers.

The Outside Influence

The county is home to several thousand acres of tallgrass prairie. An article in the fall 2000 *Kansas Magazine* entitled "Tuning into the Prairie" describes how a former native of the area and now a well-known television journalist is on a mission to tune the world in to the Kansas prairie to attract more tourism to the area. In 1997, Bill Kurtis, owner of Kurtis Productions in Chicago, purchased 5,000 acres of the tallgrass prairie and converted it to Red Buffalo Ranch. His company has also purchased 2,000 acres surrounding the location of *Little House on the Prairie*, where Laura Ingalls Wilder lived with her family in the 1870s.

Another part of the Kurtis project has been to revitalize the small community of Sedan. Toward that effort, in 1999, the Red Buffalo Ranch group began purchasing several downtown row buildings in Sedan. The plan is to restore the buildings to their original limestone facades. Already open is the Red Buffalo Bakery, along with a restaurant and coffee bar, bookstore, theater, and art gallery showcasing prairie art, products native to the state, and a line of prairie clothing.

Sedan's Downtown

The downtown area of Sedan is a four-block area. Two of the blocks are composed of downtown row structures. Most of the structures were built before 1900, and most are two-story structures, with unused second floors. The typical uses of the downtown buildings are as retail and office space. Before the creation of Red Buffalo Ranch, about one-third of the buildings were vacant. About one-half of the occupied buildings were owner occupied and the other half rentals. The physical condition of the buildings ranged from fair to good, with the functional utility typically being fair. The size of the buildings ranged from 1,000 square feet to more than 6,500 square feet.

A neighborhood may be characterized as being in a stage of growth, stability, or decline. The Sedan downtown neighborhood in the early 1990s was in decline or at least stagnant according to Terry Brown, Chautauqua County appraiser. The emergence of Red Buffalo Ranch's activity in the community in 1999 caused the downtown neighborhood to enter a period of growth and revitalization. That growth and revitalization has continued though 2000. How long this growth stage will continue is uncertain. There have not been any sales to date in 2001 to indicate if the

market in the downtown area is continuing to grow or if it is now beginning to stabilize.

Sales activity in the downtown area before 1999 was minimal. From 1995 to 1998, only two downtown row properties sold. The sales prices per front foot for these two properties were \$200 and \$480. When the Red Buffalo Ranch entered the picture in 1999, the situation changed dramatically. The company purchased three properties in 1999 and two additional properties in 2000. The sale price per front foot for the five properties ranged from \$560 to \$800. Three of the properties purchased by Red Buffalo Ranch were resale properties. The three properties had sold between 1990 and 1995 with a sale price per front foot ranging from \$300 to \$420. These resales indicated an annual market appreciation of 22 percent. An increase of this magnitude is unusual at any time, but particularly so when the market has been stable or even declining.

Since December 1999 and throughout 2000, four additional properties were sold to buyers other than Red Buffalo Ranch. The sale price per front foot for these four properties ranged from \$800 to \$1,080. The sale price per square foot has also been calculated; however, the front foot rate seems to be the

Figure 1
Average Sale Price
Per Front Foot, 1990-2000

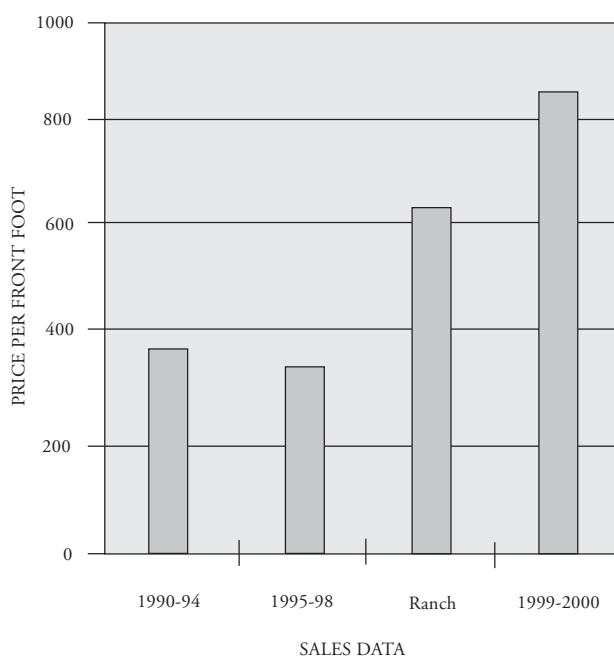


Table 1
Sedan Downtown Row Sales

Parcel number	Sale date	Sale price	First-floor use	Second-floor use	Phys cond/funct utility	Total square feet	Price per square foot	Front feet	Price per front foot
1520301003003	03/97	\$5,000	Mu Office	None	Fr/Fr	1,040	\$4.81	25	\$200
1520301003002	07/96	\$12,000	Ret/Stg	None	Fr/Fr	3,090	\$3.88	25	\$480
1520301003006	08/99	\$14,000	Off/Whs	None	Av/Fr	2,500	\$5.60	25	\$560
1520301003004	03/00	\$15,000	Retail	None	Fr/Av	1,350	\$11.11	25	\$600
1520301003005	03/00	\$15,000	Msal/Whs	Whse	Av/Fr	3,825	\$3.92	25	\$600
1520301003010	07/99	\$25,000	Retail	None	Av/Av	6,500	\$3.85	40	\$625
1520301003001	09/99	\$20,000	Retail	None	Gd/Fr	3,175	\$6.30	25	\$800
1520301003008	12/99	\$20,000	Retail	None	Av/Av	4,026	\$4.97	25	\$800
1520301003007	01/00	\$20,000	Retail	None	Av/Gd	2,996	\$6.68	25	\$800
1520301003009	06/00	\$20,000	Off/Ret	None	Pr/Fr	1,615	\$12.38	25	\$800
1520301003008	10/00	\$27,000	Ret/Man	None	Gd/Gd	4,026	\$6.71	25	\$1,080

Note: Sales in bold are those made by Red Buffalo Ranch, LLC.

most consistent unit of comparison. (See figure 1 and table 1. Note that all the sales are from the same block.)

Analysis of the Sales

The Chautauqua County appraiser and his staff field inspected and reviewed each of the five Red Buffalo Ranch properties. Three of the properties purchased by the Red Buffalo Ranch were listed for sale; the other two properties were not. The owners of the properties not listed were approached by representatives of the Red Buffalo Ranch about their purchase. At first glance, there was nothing about the sales that would cause them to be invalid except that the two sales were not available on the open market.

The real issue in this case was concern that the out-of-town buyer and seller may not have been knowledgeable about the local market. In addition, the properties were all purchased for a specific purpose by the same buyer. To determine if the out-of-town buyer and the seller were both knowledgeable about the local market, several questions could be asked of the sellers, such as:

- Was the property listed or advertised for sale?
- How did you arrive at a sale price?
- Was an appraisal made of the property?
- Was there any undue compulsion to sell?
- How long was the property on the market?

Several questions should also be asked of the buyer, such as:

- Did you look at other property in the area?
- Are you aware of the market?
- Was the property appraised for loan purposes?
- Did you talk to local realtors?
- How long did you search for property in the area?
- Was there any undue compulsion to buy?

Because there was more than one transaction between the out-of-town buyer and different sellers, and some sales were handled through local real estate agents, there was no reason to invalidate the sales. In addition, since Red Buffalo Ranch entered the market, four additional sales have occurred, thus supporting the fact that the sales represented fair market value in the Sedan downtown area. In fact, the sales probably helped establish the market and have continued to increase demand for downtown row properties.

Effect on Downtown Row Taxes

Taxable values in the Sedan downtown area began seeing the effects of the sales in 2000. Market values on the downtown row buildings in 1998 ranged from \$8,000 to \$10,000 per building. In 2000, the market values jumped to \$16,000 to \$20,000, an increase of 100 percent in most instances. In Kansas, commercial property is assessed at 25 percent of fair market value. Thus, taxable values in the area jumped from \$2,000–\$2,500 in 1998 to \$4,000–\$5,000 in 2000.

Actual taxes paid by downtown building owners

increased significantly from 1998 to 2000, not only due to valuation changes, but also to a sizeable increase in the Sedan mill levy. The levy in 1998 was 142.596 mills compared with 152.045 in 2000—an increase of 6.7 percent. The actual taxes on these downtown row buildings in 1998 ranged from \$285 to \$356 compared with \$608 to \$760 in 2000, a typical increase of more than 110 percent in actual tax dollars paid by the owners of those row buildings.

Another consequence of the valuation increases in the downtown area was the number of valuation appeals filed with the appraiser's office. In 2000, nine informal appeals were filed compared with only three in 1998, an increase of 200 percent.

Yet another concern for the county was the effect the sales would have on the annual sales ratio study conducted by the State of Kansas. In Kansas, the ratio study is a major component used to determine if a county is in appraisal compliance for the year. According to Peter L. Davis, the head of the sales ratio section for the Department of Revenue, Division of Property Valuation, in Topeka and one of the leading authorities on sales ratios for IAAO, this situation is not unique. "We see quite often changes in the economic profile of a community or neighborhood," Davis said. "What tends to happen in these cases is that we ... disregard these sales in the sales ratio study for the first year, provided the county can demonstrate or explain why the change in the economy was unexpected."

If the assessment jurisdiction is on an annual valuation cycle, as is the case in Kansas, then the problem should correct itself during the next few years, Davis noted. "The county should be taking steps to raise their market value to reflect the sales that are occurring in the neighborhood."

Whether or not to use the sales in the sales ratio study is another issue. Davis noted that if the sales were listed on the open market, they would probably be used. "We would look at each individual case," he said. "However, the ones that were not exposed to the open market would probably not be used in the study without some lengthy and detailed research to make sure they were open-market transactions, and most counties do not want to go to that much effort."

Conclusion

Several questions were posed at the beginning of this article. The first was, "Should assessors be using sales by out-of-town buyers in the valuation process for tax

purposes?" Under normal conditions, the number of sales to out-of-town buyers would be a smaller percentage than in Sedan. With the quantity of sales in Sedan, the appraiser must carefully check to ensure that all conditions are met to validate these sales. If those conditions are met, the sales must be considered valid. Only if there were a sufficient number of sales to individuals currently within the community to indicate the out-of-town sales did not reflect the market would the sales be considered invalid. As shown from the sales data, this was not the case. Therefore, the out-of-town sales must be used as an indication of market value.

A second question posed was, "When do these out-of-town sales actually reflect or become the market?" This question was answered by sales that occurred in 1999–2000 in which Red Buffalo Ranch was not involved. The sales graph showed the average front-foot sale price to Red Buffalo Ranch was \$687, and the other 1999–2000 sales averaged \$870 per front foot. In Sedan, the out-of-town buyers sparked growth by setting a higher price, but the local market forces met and raised those prices. Initially, the out-of-town sales appeared to be above market, but as the neighborhood continued to move from a stage of decline to one of growth, market sales exceeded the sales made by the Red Buffalo Ranch.

The final question was, "What effect will the sales have on the assessment jurisdiction's annual ratio study?" Fortunately, the Kansas Ratio Study has the flexibility to make allowances for unusual or extreme changes in an economic profile, such as the Sedan sales. The appraiser has a year to update values to reflect these sales. Additionally, there are other sales that would now support and justify the appraiser's valuation increases.

Although assessors recognize and have means of addressing a steady growth or steady decline in the market, all assessors dread extreme changes such as the one that occurred in Sedan.

Resources at Your Fingertips

For all your bibliographic needs, see MemberLink on the IAAO website. You will need a member password to log on. To obtain a password, e-mail webmaster@iaao.org.
